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TAGS: EFIN ECON MA
SUBJECT: MOROCCO REACHES INVESTMENT GRADE

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¶1. (SBU) Summary: Fitch Ratings' April 19 decision to raise Morocco to investment grade has been welcomed by Moroccan government and media as a vote of confidence in the country's ongoing economic reforms. Fitch noted Moroccan progress across the range of "economic, political and social areas," pointing in particular to the country's current account surplus, progress in reducing its budget deficit, and structural transition to a more balanced economy. Risks remain-- Fitch highlighted an overall Moroccan debt burden that is above the median for its peer group, continued vulnerability to both climactic and oil price shocks, and persistent poverty. Nonetheless, the ratings agency predicts not only that external debt and liquidity ratios to improve in 2007 and 2008, but that current reform momentum will be sustained beyond this year's elections. A similar vote of confidence was registered earlier in April in Washington, where World Bank officials praised Morocco's progress, following a meeting with Finance Minister Oualalou. End Summary.

¶2. (U) On April 19, Fitch became the first of the three major ratings agencies to accord Morocco a rating that is at investment grade, albeit at the low end of the scale. Morocco was assigned a foreign currency IDR of BBB-, and a local currency IDR of BBB, both with stable outlooks. The country also gained a short-term foreign currency rating of F3 and a country ceiling of BBB. (Standard and Poor's and Moody's have also recently upgraded Morocco, but their ratings remain just short of investment grade.)

¶3. (U) Especially important for Morocco was the agency's endorsement of Morocco's recent reform trajectory. Fitch noted progress across the political, economic, and social spectra, arguing that this had "translated into continuing improvements in living standards and the external position, notwithstanding persistent fiscal deficits." Noting that the Moroccan current account has been in surplus since 2001 (largely due to growing tourism revenue and transfers from Moroccans resident abroad-- so-called MREs) and that Morocco made progress in 2006 in reducing its budget deficit (to 1.7 percent of GDP), Fitch predicted that receipts from tourism, light manufactured products, and FDI will continue to grow at a fast pace, allowing continued improvement in Morocco's external position in coming years. Significantly, it predicted that this reform momentum will be sustained through the coming electoral cycle.

¶4. (U) While conceding that with 40 percent of its population

engaged in agriculture and without significant energy resources, Morocco is vulnerable to both climactic and oil price shocks, Fitch argued that Morocco has entered a "transition phase." Significant investments aimed at enhancing its comparative advantages in tourism, "offshoring," and similar sectors, it argued, will limit these vulnerabilities. Fitch did concede that beyond a high debt burden, Morocco does continue to have difficulty in translating its economic reforms into reduced poverty and unemployment. Nonetheless it saluted its effort to de-couple the state from the economy, to reduce administrative barriers to entrepreneurship, and to restructure the banking system and modernize its financial markets. It identified a key Moroccan advantage as stemming directly from MRE transfers, which boost domestic bank deposits and allow a "deep domestic debt market" with an average maturity of almost seven years.

¶5. (U) Fitch noted progress in public sector reform that enabled the budget deficit to be brought below 2 percent of GDP in 2006, despite a narrow tax base and continued subsidies for energy and other primary goods. It predicted the deficit will rise slightly this year, before falling in coming years. Despite a debt to GDP ratio above the median for its peers (the reason Moody's did not raise Morocco to investment grade), Fitch noted that "the external situation is far stronger," resulting in the Morocco's "unusual" position as a "BBB" country that is both a public and overall net external creditor.

¶6. (U) Fitch's endorsement of Morocco followed by a week similar compliments from the World Bank. In a meeting on the margins of the annual World Bank/IMF meetings, Finance Minister Oualalou reviewed Morocco's recent progress with bank leaders. They saluted Morocco's work to advance "good

governance" and stressed the bank's readiness to assist Morocco's efforts in that area.

¶7. (SBU) Comment: Fitch's analysis tracks largely with our own assessment of Morocco's progress, though we would place greater emphasis on the work that remains to be done in reducing administrative barriers to business and in spurring judicial and legal reform. A recent Finance Ministry study (subject of septel) also calls into question how much of a contribution exports will make to Morocco's economic growth in future, arguing that since 1995 their competitivity has continued to slip, notwithstanding numerous sectoral initiatives to assist them. Finance Ministry contacts have expressed pleasure with the upgrade, while arguing that it should have occurred much sooner, given the positive tone of rating agency reports on Morocco. End Comment.

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